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UTAH TECHNOLOGY REPORT

Industrial Loan Corporations



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EXECUTIVE SUMMARY

With approximately \$82 billion in assets, Utah is the leading state in the Industrial Loan Corporation (ILC) industry, dwarfing its competition from California, at \$10 billion, and Colorado, at \$630 million. The State's business friendly regulatory environment, enabling ILCs to export interest rates and credit terms and conduct business across state lines without being subject to other state regulations, has attracted a critical mass of the industry's leading ILCs including Merrill Lynch Bank USA, with holdings valued at approximately \$54 billion, American Express Centurion Bank, valued at \$17 billion, and GE Capital Financial, valued at almost \$2 billion.

Utah's fledgling ILC presence has a number of positive implications for the state's economic growth and general welfare. These include:

- **Industry Reputation and Growth:** Increasing the State's credibility as a "pro-business" state, laying the foundation for the State's growing financial services sector;
- **Employment Growth:** Employing 8-10,000 Utahns, paying above minimum wage and providing growth opportunities for talented individuals;
- **Community Investment:** Investing a small portion of assets into community improvement initiatives; and
- **Taxes:** Reaping the benefits of an expanding tax base as more companies choose to charter their ILCs in Utah.

However, in order to continue leveraging these benefits, the State must keep regulatory practices minimal. Otherwise, they run the risk of ILCs establishing charters in other states, transferring assets in mere minutes, at low cost and with relative ease.

There is tremendous potential to initiate an influx of needed second- and third-round venture capital resources, through leveraging a minority portion, a suggested 20 percent, of required Community Reinvestment Act (CRA) funding. In brief, this initiative would require several actions:

1. Articulating a vision that engenders the support of key parties (ILCs, federal and state regulators, legislators, non-profit organizations, and the venture capital community), encouraging investment in Utah's future economic welfare by designating a portion of CRA monies for funding some of Utah's most promising companies.
2. Indirectly influencing the formation of Small Business Investment Companies (SBIC), creating another avenue that ILCs can invest CRA funding into, which focus on providing second- and third-round funding to promising Utah start-ups.

The success of these endeavors would result in an infusion of capital into Utah's small businesses; stimulating job growth, backing those companies with proven innovation and

business practices most likely to advance the farthest, and circulating resources throughout the economy, benefiting all Utah residents.

The following summarizes the observations and resulting recommendations of this report.

OBSERVATIONS

INDUSTRIAL LOAN CORPORATIONS

Observation #1: Industrial Loan Corporations have flourished, as a way for non-banking companies to own a bank insured by the FDIC and not regulated by either the Federal Reserve or the Office of the Comptroller of the Currency.

Observation #2: Industrial Loan Corporations have recently risen in popularity as credible financial intuitions with solid returns, garnering the interest of major corporations like Merrill Lynch, American Express, BMW, Microsoft, and Wal-Mart.

Observation #3: An ILC's value proposition poses two major benefits for parent companies: it enables vertical integration for industrial corporations wishing to own more of the customer relationship and it creates an avenue for a corporation's resources with "lighter" regulation.

Observation #4: There are several barriers to companies interested in forming ILCs, including a lack of perceived value, knowledge, and lobbying efforts seeking to prevent companies from forming ILCs.

COMPETITIVE LANDSCAPE OF THE ILC INDUSTRY

Observation #5: The ILC market is not likely to reach saturation, even though more companies are investigating this form of business because ILCs are generally a vertical arm of their parent companies, operating in a niche market and often not competing with one another.

Observation #6: With approximately \$82 billion in assets and a critical mass of leading ILCs, Utah's "business friendly" regulatory environment has enabled it to gain such a foothold in the market that California and Colorado pose little competition in this sector.

Observation #7: The phenomenal growth of Utah's ILC presence, projected to reach \$200 billion within five years, may be largely attributed to both its friendly regulatory environment and the ease with which parent companies can transfer assets to their ILCs.

Observation #8: Although only Utah, California, and Colorado can issue ILC charters, other states have somewhat similar charter options, which can pose a competitive threat to any state issuing ILC charters in an unfriendly regulatory environment.

Observation #9: Utah’s competitive advantage as a “business friendly” regulatory environment is tenuous, since regulations can be subject to change at any time. Thus, if Utah’s regulatory environment were to become more restrictive, ILCs could apply for a charter in another state for a minimal cost and transfer assets with relative ease in a matter of minutes.

REGULATORY ENVIRONMENT

Observation #10: Part of an operational mandate, ILCs must comply with the Community Reinvestment Act (CRA), which is designed to encourage depository institutions to help meet the financial needs of the communities in which they operate and remain consistent with “safe and sound” banking operations.

Observation #11: Currently, the “rule of thumb” for meeting CRA requirements is about one percent of assets. Based on this, there is approximately \$820 million in available CRA funding. However, the FDIC largely feels that there is more funding available than investment opportunity, and thus provides satisfactory CRA ratings to those banks that show “good faith” effort in cultivating community needs and fulfilling investment opportunities.

BENEFITS OF ILCs IN UTAH

Observation #12: The ILC industry is a key contributor to the state of Utah, providing jobs, infusing capital into the region through taxes, state fees, community reinvestment monies, and commercial real estate rents.

IMPLICATIONS FOR ILC INVESTMENT IN VENTURE CAPITAL

Observation #13: Industrial Loan Corporations can play a major role in alleviating the second- and third-round financing discrepancy that is often critical to a company’s ability to make an initial public offering.

Observation #14: The potential to channel CRA investments into second- and third-round venture capital funding presents a real opportunity for Utah to further develop and strengthen its high-tech base, and thus its economy, having vast implications for economically challenged communities. Under the current environment, the ability exists to allocate a reasonable portion, 20 to 30 percent, of the substantial CRA funding pool of approximately \$1 billion to entities dedicated to later stage financing and thus, Utah’s future economic well being, without impacting current investment initiatives such as low-income housing loans, credit education, non-profit organizational charters, etc.

RECOMMENDATIONS

Recommendation #1: Influence ILCs to invest in Utah's future economic growth and health, benefiting everyone, by apportioning an appropriate amount of their CRA investments to later stage funding of venture capital in Utah. Governor Leavitt can play a key role in this process by providing this vision and garnering support not only among ILCs but also local, state, and federal government, as well as venture capital firms, banking associations such as the Utah Association of Financial Services, banking regulators, and Utah's citizens. It is important to note that this initiative is not a diversion from the needs of Utah's economically challenged, but rather, an investment in Utah's future economic growth, benefiting all participants by stimulating economic vitality and job growth.

Recommendation #2: Encourage the formation of new Small Business Investment Companies (SBIC) to be set up in Utah that focus on second- and third-round venture funding. In order to effectively fulfill the "safe and sound" investment test imposed by the Department of Financial Institutions and the FDIC, this requires identifying a seasoned management team that has a track record of success in later stage financing. Investing through an SBIC is the simplest method for ILCs to meet CRA requirements for investing in small businesses. Since currently, Utah's SBICs are set up to focus mainly on seed funding, new SBICS, licensed to fund second- and third-rounds, should be established.

Recommendation #3: Establish and champion a modest and attainable objective of securing approximately 20 percent of ILCs' CRA funding, increasing the emphasis and endorsement of economic development in the form of venture capital through investment in SBICs.

Recommendation #4: Develop and conduct a public relations campaign that articulates the importance of ILCs to Utah's economic development and the important role they can play in funding some of the State's most promising companies and innovations, building and strengthening Utah's economic future—ultimately benefiting all Utahns. Research conducted indicates that, more often than not, ILCs, government agencies, local venture capitalists, and community entities have contrasting interpretations and viewpoints in this area. The alignment of these groups is crucial to maximizing the potential of the ILC industry in this endeavor.

Recommendation #5: Create avenues for recognition of local ILCs and the great impact they can have on Utah's economy and the community at large. Delineate the positive benefits Utahns derive from having a critical mass of ILCs within the state. This may include an influx of higher paying, skilled jobs, funding for community enhancement, and prestige for Utah as a financial center.

Recommendation #6: Convey the benefits of and potential implications for the ILC industry in Utah to legislative decision-makers, engendering continued support. Emphasize the importance of having a critical mass of ILCs remain in the State, as well

as the fact that their tenure here can be tenuous, dependent upon the future regulatory environment.

UTAH INDUSTRIAL LOAN CORPORATIONS

Below is a contact list of ILCs that already exist in Utah. It is important to remember that many of these ILCs are already leading companies within the greater ILC industry and have laid the foundation for Utah's growing financial services sector.

Company	President	General Phone #
<i>Utah Companies:</i>		
Advanta Bank Corporation (Draper, UT) www.advantabank.com	Jeffrey D. Beck	(801) 523-0858
American Express Centurion Bank (Midvale, UT) www.finance.americanexpress.com	David E. Poulson	(801) 565-5000
American Investment Financial (Midvale, UT) www.aifusa.com	Kent Landvatter	(801) 352-2877
Associates Capital Bank (Salt Lake City, UT) www.associatescapitalbank.com	Brian Withham	(801) 715-7456
BMW Financial Services (Salt Lake City, UT) www.banking.bmwusa.com	David Paul	(801) 994-7885
Celtic Bank (Salt Lake City, UT) www.celticbanking.com	Reese Howell (VP)	(801) 363-6500
CIT Online Bank (Salt Lake City, UT) www.citigroup.com	Richard P. Lake	(801) 947-7563
CitiFinancial Services, Inc. (Murray, UT) www.citigroup.com	Bill Clements, Jr. (District Manager)	(801) 728-9186
Conseco Bank, Inc. (Salt Lake City, UT) www.consecobank.com	Brent Peterson	(801) 944-3374
Escrow Bank USA (Midvale, UT) www.escrowbankusa.com	Steve Nielsen	(801) 352-0083
First Electronic Bank (Draper, UT)	Jim McLaughlin	(801) 572-4004
First USA Financial Services, Inc.. (Salt Lake City, UT) www.bankone.com	James W. Baumgartner	(801) 281-5800
GE Capital Financial Inc. (Salt Lake City, UT) www.ge.com/capital/cardservices/corpcard	Jeffrey R. Dye	(801) 517-5000
Merrick Bank Corporation (South Jordan, UT) www.merrickbank.com	Richard L. Urritia	(801) 685-7700
Merrill Lynch Bank USA (Salt Lake City, UT) www.ml.com	Preston L. Jackson	(801) 526-8300

<i>Morgan Stanley Dean Witter Bank</i> (Sandy, UT) www.morganstanley.com	Robert D. Myrick	(801) 566-4161
<i>Pitney Bowes Bank</i> (Salt Lake City, UT) www.pb.com	Zock B. Goeckeritz	(801) 281-5522
<i>Providian Bank</i> (Salt Lake City, UT) www.providian.com	Mark Zupon	(801) 519-0555
<i>Republic Bank</i> (West Bountiful, UT) www.republic-bank.com	Boyd Lindquist	(801) 397-0613
<i>Transportation Alliance Bank</i> (Ogden, UT) www.tabbank.com	Clint E. Williams	(801) 334-4800
<i>Universal Financial Corporation</i> (Salt Lake City, UT)	Steve Taylor	(801) 453-1380
<i>Valley Loan Corporation</i> (Murray, UT)	Robert I. Bowes	(801) 968-9093
<i>Volvo Commercial Credit Corp. of Utah</i> (Salt Lake City, UT) www.volvo.com	Wallace M. Jensen	(801) 266-8524
<i>Web Bank Corp.</i> (Salt Lake City, UT) www.webbank.com	Kenneth H. Peterson	(801) 993-5050
<i>Wright Express Financial Services</i> (Murray, UT) www.wexcorporatecard.com	Steven A. Hoskins	(801) 270-2660
<i>Your:)Bank.com</i> (Salt Lake City, UT)	John L. Richards	(801) 412-6524

INTRODUCTION

WHAT IS AN ILC?

An industrial loan corporation (ILC) is a depository charter that:

- Can be owned by a non-bank;
- Is eligible for FDIC insurance; and
- Is excepted from the definition of a “bank” set forth in the Bank Holding Company Act of 1956 (BHCA).



The ILC has become an attractive charter for non-bank companies that want to own a financial institution, but do not want to be subject to most of the restrictions imposed by the federal Bank Holding Company Act, which outlines two main functions that constitute a bank (commercial loans and demand deposits) and discriminates between banking and non-banking activities.¹ A Utah-chartered ILC is a depository institution subject to the same state regulatory oversight as a Utah-chartered commercial bank. (Both are regulated by the Department of Financial Institutions.)

SCOPE OF ILC FUNCTIONS

Generally, ILCs are authorized to make all kinds of consumer and commercial loans and to accept federally insured deposits, but not demand deposits if they have total assets greater than \$100 million.

An ILC mainstay has been the issuance of credit cards to consumers and businesses nationally.

The flexibility of an ILC charter has made it an attractive vehicle for some large and well-know corporations. ILCs offer a versatile depository institution charter for companies not permitted to, or choosing not to, become subject to the parent company activity limitations under the Bank Holding Company Act. Companies such as American Express, GE Capital Financial, Merrill Lynch and others have taken advantage of the exportation of interest and other charges afforded national banks and federally insured, state-chartered financial institutions. An ILC mainstay has been the issuance of credit cards to consumers and businesses nationally.

ILCs are subject to safety and soundness examinations by the Department of Financial Institutions and the Federal Deposit Insurance Corporation (FDIC). An ILC is also subject to the Community Reinvestment Act (CRA) and consequently receives a periodic compliance examination. (See also section on *Regulatory Issues for ILCs*)

VALUE PROPOSITION OF ILCs

ILCs have a compelling value proposition for both the corporations forming them and the states in which the companies choose to charter. The following value proposition analysis is Utah-specific.

FOR THE STATE

Taxes—Because ILCs are corporations in the state in which they are chartered, the majority of their taxes are paid to that state.

CRA funds—Each ILC is required to reinvest in the community in which it operates. The rule of thumb is one percent of total assets. Banks are also subject to this regulation, but total assets of state chartered banks totaled \$3.1 billion in June 2000, compared with ILC assets of \$82 billion, reducing the comparative impact that bank CRA investment has in the State.

Employment—It is estimated that 8-10,000 people are employed directly due to ILC activities within the State. These tend to be good jobs with career paths internally for talented individuals.

Reputation—The State increases in its credibility as prominent corporations locate within the borders. The prestige of the State as the “Delaware of the West” can be attributed to the ILC industry’s growth in Utah. The growth and credibility Utah is gaining, as a State, in the financial service sector is largely a result of the ILC industry.

FOR CORPORATIONS

Regulation—The true value proposition of an ILC is who regulates you—or more precisely, who doesn’t regulate you, namely the Federal Reserve. ILCs are only subject to regulation by the FDIC and the relevant state regulators (i.e. Department of Financial Institutions).

Vertical integration—ILCs provide a way for industrial corporations to expand their ownership of the customer relationship, effectively getting once step closer to their customers, as they eliminate the middleman.

Funding Source Expansion—ILCs allow parent companies to tap into other funding sources and liquidity available to the parent company through the ILC, which can certainly help expand their business.

Opportunity Cost— From an opportunity cost perspective it would be rational to assume that parent companies can make better returns through the formation of an ILC than through alternative investment opportunities, since the free market is seeing the organization of ILCs with some of the nation’s lending corporations.

HISTORICAL CONTEXT



While ILCs have been in existence for over 80 years, only recently have they risen in popularity as credible financial intuitions with solid returns, garnering the interest of major corporations. The last 14 years of the ILC industry have seen some significant changes, and thus, will be discussed in-depth below.

Since then, (ILCs)...have flourished, as a way for non-banking companies to own a bank insured by the FDIC, but not subject to regulation by either the Federal Reserve or the Office of the Comptroller of the Currency.

ILCs have been around since the 1920s, when they provided the sort of low-quality, high interest rate industrial loans that ordinary banks shunned. This form of potentially risky lending has formed a basis for a negative perception of ILC activities, despite their overall current record as strong, credible intuitions. In 1986, following some embarrassing and costly failures, ILCs were required to be insured with

the FDIC. Since then, they have flourished, as a way for non-banking companies to own a bank insured by the FDIC, but not subject to regulation by either the Federal Reserve or the Office of the Comptroller of the Currency.²

ILC Timeline

Pre-1987: The Bank Holding Company Act defined a “bank” as an institution that made:
(1) Commercial loans and
(2) Accepted demand deposits.

This definition created the “non-bank bank” loophole by which these non-bank banks could do either commercial loans *or* demand deposits but not both.

1987-present: The Competitive Equality Banking Act of 1987 (CEBA) closed the non-bank bank loophole by changing the definition of “bank” to include any institution having FDIC insurance, potentially including ILCs. However, CEBA also carved out some important exceptions to the definition of the term “bank,” including the exception that reintroduced ILCs, which provides that an ILC is not a “bank” if it is:

Organized under the laws of a State which, on March 5, 1987, had in effect or had under consideration in such State’s legislature a statute which required or would require such institution to obtain insurance under the Federal Deposit Insurance Act and

- Does not accept demand deposits that the depositor may withdraw by check or similar means for payment to third parties;

- Possesses total assets of less than \$100 million;
- The control of which is not acquired by any company after August 10, 1997; or
- Does not, directly, indirectly, or through an affiliate, engage in any activity in which it was not lawfully engaged as of March 5, 1987.³

INDUSTRY CONTEXT

The ILC charter essentially allows industrial companies (non-banks) to own banks. This serves the basic purpose of vertical integration for industrial corporations wishing to own more of the customer relationship. The ILC charter also enables parent companies to tap into other funding sources and liquidity to expand their business. Additionally, the ILC charter creates an avenue for a corporation's resources with "lighter" regulation (no Federal Reserve oversight).

Some barriers to companies forming ILCs include a lack of perceived value, knowledge, and lobbying efforts seeking to prevent companies from forming ILCs.

However, the desire of corporations to expand the scope of the customer relationship beyond the interaction associated with their core offerings to financial services creates the perceived need to form an entity such as an ILC.

Some companies do not yet recognize a need to form an ILC to meet the needs of their customers. However, the desire of corporations to expand the scope of the customer relationship (effectively "owning" more of their customers' commerce) beyond the interaction associated with their core offerings to financial services creates the perceived need to form an entity such as an ILC. BMW decided to form an ILC when they wanted to vertically integrate and thus expand the customer relationship beyond cars to their customers' financial needs. There are other options for providing financial services to

customers such as certain types of credit unions or national thrift associations. However, the ILC expands and enriches the financial services offering above and beyond supplementary options. Furthermore, ILCs allow these companies to tap into other funding sources and liquidity, which can certainly help expand their business.

The other barrier to forming an ILC is knowledge. Some industrial companies may not know a lot about ILCs or how they are set up. The knowledge of an ILCs opportunity to earn a higher return on liquid assets while extending the customer relationship will increase as the ILC model gains more awareness and popularity.

The last barrier to having new charters submitted is the potential lobby against certain companies obtaining ILC charters. In the June 2001 issue of *The Economist* it was reported that companies such as Microsoft and Wal-Mart (the largest employer in the world) are rumored to be interested in chartering ILCs, but might not receive FDIC

approval, due to a potential lobby of “small, traditional” banks that fear the competition these powerhouses present to the banking industry.⁴

The industry for ILCs specifically is contained to Utah, California, and Colorado. However, while only three states can issue ILC charters, other states do have somewhat similar charter options. Essentially Utah, California, and Colorado have the “ILC” terminology, but they do not have a lock on entities formed under alternative charters in other states.

...Other states do have somewhat similar charter options. These...become a competitive threat to a state issuing ILC charters when the State's regulatory environment becomes unfriendly to the ILC industry. .

These alternative charters only become a competitive threat to a state issuing ILC charters when the State's regulatory environment becomes unfriendly to the ILC industry.

The regulatory environments widely differ between three states issuing ILC charters. The result of that is a wide disparity in the number and size of companies charting ILC's in each state:

- Utah \$82 billion in assets (approx. 25 ILCs)
- California \$10 billion in assets (approx. 23 ILCs)
- Colorado \$630 million in assets (approx. 5 ILCs).



The asset total for ILCs is important because of the rule of thumb in the industry that ILCs fulfill their CRA obligation by giving one percent of their assets to the communities in which they reside.

Compared to Utah, the markets in California and Colorado are inconsequential. While Utah is home to the banks of powerhouse parent companies like Merrill Lynch, American Express, GE, and others. California and Colorado's ILCs are mainly lesser-known local companies. This explains why California has approximately the same number of ILCs as Utah, but their total assets are a mere \$10 billion compared to Utah's \$82 billion. The per capita asset levels of the ILCs in California and Colorado are not likely to mirror the per capita asset level of Utah ILCs because the majority of ILCs in California and Colorado do not have parent companies with large amounts of assets that could be transferred to the ILC balance sheet. Merrill Lynch, easily the largest ILC in terms of assets, illustrates how ILCs can transfer assets from their parent company. In December 1998 Merrill Lynch's ILC had less than \$1 billion in assets. This rose sharply to \$31 billion in September of 2000 and again to \$54 billion six months later in March of 2001. This explosive growth was due to Merrill Lynch's mandate to push much of the cash held by its stock broking clients into accounts in its ILC.

Recently Gray Davis, governor of California, has changed legislation to try to make inroads to the booming ILC market.

The ILC environment varies widely between the three states issuing charters. For instance, California is generally thought of as an unfriendly state for ILCs as well as business in general due to the State's strong regulatory environment. Another downside of California is the higher

costs of doing business within the state. Recently, recognizing an ILC's potential value proposition for a host state, Gray Davis, governor of California, changed ILC regulatory legislation to try to make inroads in the booming ILC market. Late in 2000, Governor Davis signed a bill that gave the State's ILCs many of the same powers as commercial banks, including the right to conduct transactions with parent companies and affiliates.

"Under the former law, if a member of the board of directors of an industrial loan company owned an automobile dealership in the community, the bank could not finance loans or purchase contracts from that dealership," said Bernard B. Nebenzahl, an attorney who lobbied for the new law on behalf of the California Association of Industrial Bankers.

In addition, California's 23 industrial banks had previously been prohibited from doing business with customers of their parent companies. But under the new California law, these banks now have the ability to lend to such customers -- a change supporters say will make its charter far more attractive. While California is

California is beginning to acknowledge that they understand the value of having these companies within their borders

beginning to acknowledge that they understand the value of having these companies within their borders⁵, the opinion among ILCs in Utah is that these changes are merely surface changes and are not significant enough to make California more desirable than Utah for ILCs, due to the general red tape associated with doing business in California and more stringent consumer credit laws.

The environment for the ILC industry is less favorable in the State of Colorado. Colorado currently has five ILCs chartered in the state, predominately local companies, with assets totaling \$630 million. In general, Colorado has not actively sought to attract ILCs to charter in the state, and does not have as friendly of a regulatory environment as Utah. A description of the ILC environment in Colorado could be made as even resistant because of the many laws and restrictions in place seeking to limit an ILC's activities.

One Utah-based ILC president stated that even if Utah law for ILCs became unfavorable, he would not move to another state, but instead would most likely abandon the ILC name and seek other ways to perform the same functions...

Utah has by far the best regulatory environment for the ILC industry. This type of competitive advantage is tenuous however, since these regulations can always be changed. For major corporations wishing to establish an ILC, the regulatory environment largely a decision-breaker. One Utah-based ILC president stated that if Utah law for ILCs became unfavorable, he would most likely abandon the ILC name

and seek other ways to perform the same functions by using a similar charter option available in Utah or in another state. Utah is so far ahead of California and Colorado both legislatively (California's state banking code with 100 sections is extremely complex vis-à-vis Utah's banking code with only 14 sections) and in gaining a critical mass of ILCs, that California and Colorado do not pose much of a competitive threat to Utah's share of

the ILC industry. The only significant threat to Utah's share of the ILC industry is itself, or rather its regulations.

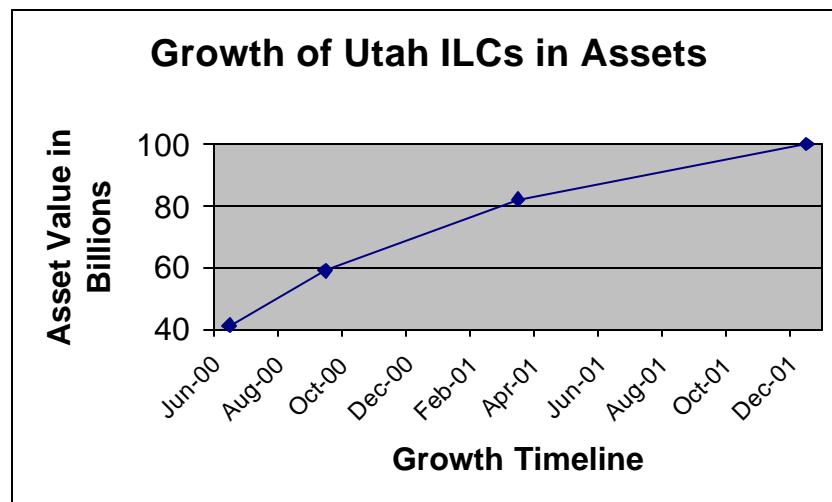
GROWTH PROJECTIONS

Since ILCs are generally a vertical arm of larger parent companies, operating in the niche market of their parent, they often times do not compete with one another. Thus, the ILC market is not likely to reach saturation (as the credit card industry has), even though more companies are investigating this form of business.

The growth outlook for the ILC industry is very promising—although it is most promising in Utah vis-à-vis California and Colorado. Industrial loan corporation assets under management in Utah have risen from \$2.9 billion at the end of 1995 to \$59 billion in September 2000 to \$82 billion in March, and it is projected to be \$100 billion by year-end.⁶ California and Colorado are no longer growing, as ILCs are slowly abandoning their charters in these states.

The phenomenal growth in Utah may be attributed to both its friendly regulatory environment and the ease in which parent companies can transfer assets to their ILCs. Specifically, asset growth from the parent company typically results in an electronic transfer of parent company holdings, not from increased customers or revenues and consequently, this does not mirror typical growth implications such as a larger employee base or higher corporate income taxes paid to the State. For example, Merrill Lynch grew from \$1 billion in assets to \$60 billion in assets by simply understanding more about their charter's options.

The growth of Utah's ILC industry can be best divided into two areas—existing charters and potential charters. The growth of the market in existing charters is estimated to be \$200 billion within the next five years (effectively doubling its current size of \$82 billion).



Growth in potential charters is more difficult to quantify. The Utah Department of Financial Institutions estimates that it receives four to five incoming calls a week from companies interested in chartering an ILC. Obviously not all calls materialize quickly into charters, since only about four to five ILCs are actually chartered each year in Utah, but potentially as ILCs gain more mindshare and acceptance, that could change.

If the current trend of processing approximately four to five new charters a year continues, the number of players in Utah could also double in the next four to five years. Thus, this area is infinitely large—barring any new unfavorable legislation that might limit the growth of ILCs in the new state or the number of charters Utah can issue. As discussed earlier, the critical mass of ILCs residing in Utah has positioned the State prominently ahead of competing states within the industry. Advantages for companies choosing to charter their ILC in Utah are both a very business friendly regulatory environment and no caps on interest rates. Utah also has a highly skilled workforce and a lower cost of living than competing ILC states—two additional advantages for companies choosing to charter in Utah.



The aforementioned advantages of charting an ILC (see also section on “Value Proposition of an ILC”) in Utah are so widely known that the Department of Financial Institutions does not need to market itself to any companies looking to establish ILCs. However, Utah is walking a fine line with new ILC charters. While Utah would like to have more ILC business in the State, at the same time it doesn’t want to attract Federal attention because of potential Federal interference resulting in tighter regulations (effectively eliminating a large benefit to the ILC charter).

The ease of exportation makes the competitive advantages of Utah’s ILC environment tenuous. As a cautionary note, if Utah’s regulatory environment were to become more restrictive on ILCs, the ILCs could apply for a charter in another state for a minimal cost and transfer assets with relative ease in a matter of minutes.

The growth outlook for ILCs in California is dim. In fact, the number of California chartered ILCs has decreased each year for the past few years and despite recent regulatory changes, skeptics do not anticipate a reversal of this trend. Colorado’s growth outlook is even more dismal than California’s because Colorado had not yet acknowledged the desire to have ILCs in their State and therefore, has made no attempts to attract the industry.

REGULATORY ISSUES FOR ILCs

ILCs are not as heavily regulated as their traditional banking counterparts, being exempted from Federal Reserve and Office of the Comptroller oversight. Additionally, ILCs are governed by the FDIC and the relevant regulatory offices of the state in which they reside. Due to limited federal oversight, individual state regulations are more so determining factors in the selection of a charter state. A “business-friendly” regulatory environment, such as Utah’s, is one of the largest advantages of the ILC charter for parent companies. The following sections outline pertinent regulatory issues for ILCs.

FEDERAL RESERVE OVERSIGHT

As previously stated, the Federal Reserve does not have regulatory oversight in the ILC industry (see also, *Value Proposition of an ILC*). However, the booming ILC industry has gained a lot of attention as it experiences explosive growth, attracting the interest of large corporations looking to establish financial entities outside the scope of the Federal Reserve’s regulatory domain. While there is no suggestion that ILCs are unstable and non-credible businesses, the Federal Reserve does not look fondly on the way that some of the world's leading industrial companies are getting into banking unscrutinised by its regulators.⁷ Whether or not ILCs will remain out of the domain of the Federal Reserve is a question that has yet to be answered.



COMMUNITY REINVESTMENT ACT

ILCs are required to comply with the 1977 Community Reinvestment Act, intended to encourage depository institutions to help meet the financial needs of the communities in which they operate, including low- to moderate-income neighborhoods, and consistent with “safe and sound” banking operations...

To prevent redlining, banks are under the intense scrutiny of regulators seeking to ensure a balance is being struck in loan granting practices and to monitor for adequate loan dispersion to low income sections of the county in which the banks operate. As with traditional banks, ILCs are required to comply with the 1977 Community Reinvestment Act (CRA), intended to encourage depository institutions to help meet the financial needs of

the communities in which they operate, including low- to moderate-income neighborhoods, and consistent with “safe and sound” banking operations.⁸ To ensure that ILCs are meeting this standard, a CRA evaluation by the FDIC is required periodically, approximately every two years, for all insured depository institutions. Based on their performance, each bank is then assigned one of four ratings: “outstanding,” “satisfactory,” “needs to improve,” or “substantial noncompliance.”

An organization with a CRA rating below “satisfactory” may be prevented from participating in a merger or acquisition, although this is not always enforced. While this is the only preset consequence for companies, ratings and a summary of each

performance evaluation must be made public, enabling communities to file complaints and put pressure on negligent institutions to improve.

Under associated legal precedence, federal regulatory agencies including the Federal Reserve, the Office of the Comptroller of Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation (which evaluates ILCs), evaluate a financial institution through a performance-based examination, the scope of which is determined by the institution's size and business strategy. Large, retail-oriented institutions are examined using the lending, investment, and service tests. Small institutions are examined using a streamlined small institution test.

Wholesale and limited purpose institutions are examined under a community development test. All institutions have the option of being evaluated according to a strategic plan developed by the company and a personalized set of criteria, by which each company is rated and approved by the FDIC. No matter which evaluation method is used, each institution's performance is evaluated according to a "performance context" that examiners factor into their CRA evaluations. This performance context includes the consideration of factors such as each institution's business strategy and constraints, as well as the needs of, and opportunities afforded by, the communities served.⁹

All methods of evaluation have been used for ILCs in Utah, although the most common test is the small bank test. Following is a description of each test and further explanation of the associated performance context.¹⁰

LARGE RETAIL INSTITUTIONS

The tests also call for qualitative consideration of an institution's activities, including whether... loans, investments, and services are responsive to community credit needs; whether...they are innovative, flexible, or complex activities...

Large retail institutions are subject to lending, investment, and service tests. These tests primarily consider things such as the number and dollar amount of loans, qualified investments, and services, as well as the location, financial status, and recipients of these activities. The tests also call for qualitative consideration of an institution's activities, including whether, and to what extent, loans, investments, and services are responsive to community credit needs; whether and to what

extent they are innovative, flexible, or complex activities; and, in the case of investments, the degree to which the investments are not routinely provided by private investors. Thus, these regulations attempt to temper their reliance on quantitative factors by requiring examiners to evaluate qualitative factors as well, since not all activities of the same numerical magnitude have equal impact or entail the same relative importance when undertaken by different institutions in different communities.

Lending test. Agencies evaluate an institution's lending performance by considering the number and amount of loans originated or purchased by the institution in its assessment area; the geographic distribution of its lending; characteristics of its borrowers, such as their income level; its community development lending initiatives; and its use of

innovative or flexible lending practices to address the credit needs of low- or moderate-income individuals or geographies in a “safe and sound” manner.

Investment test. Agencies evaluate large retail institutions’ performance under the investment test according to the dollar amount of qualified investments; the innovativeness or complexity of these investments; their responsiveness to credit and community development needs, and the degree to which they are not routinely provided by private investors. Agencies have included the investment test in CRA evaluations in recognition that investments, as well as loans, can help meet credit needs.

Service test. Under the service test, agencies consider an institution’s branch distribution among geographies of different income levels; its record of opening and closing branches, particularly in low- and moderate-income geographies; the availability and effectiveness of alternative systems for delivering retail banking services in low- and moderate-income geographies; and the range of services provided in geographies of all income levels; as well as the extent to which those services are tailored to meet the needs of those geographies. The agencies also consider the extent to which an institution provides community development services and the innovativeness and responsiveness of those services. (See Appendix A for additional information about the lending, investment, and services tests.)

Community development activities of large retail institutions. Under CRA regulation, “community development” means affordable housing (including multifamily rental housing) for low- to moderate-income individuals; community services targeted to low- to moderate-income individuals; activities that promote economic development by financing small businesses and farms; and activities that revitalize or stabilize low- to moderate-income geographies.

Tables 1 and 2 below provide the point scale used for the lending, investment, and service tests. Because more emphasis is placed on the lending test, an institution may not receive an overall “satisfactory” rating unless it receives at least a “low satisfactory” on the lending test, as the total points are capped at three times the lending score.¹¹ Thus, a bank that receives an “outstanding” rating on the lending test receives an overall assigned rating of at least “satisfactory.” A bank that receives an “outstanding” rating on both the service test and the investment test and a rating of at least “high satisfactory” on the lending test receives an assigned rating of “outstanding.”

Table 1: POINTS ASSIGNED FOR PERFORMANCE UNDER LENDING, INVESTMENT AND SERVICE TESTS

	Lending	Service	Investment
Outstanding	12	6	6
High Satisfactory	9	4	4
Low Satisfactory	6	3	3
Needs to Improve	3	1	1
Substantial Noncompliance	0	0	0

Source: Federal Financial Institutions Examination Council

**Table 2: COMPOSITE RATING POINT REQUIREMENTS
(Add points from three tests)**

Rating	Total Points
Outstanding	20 or over
Satisfactory	11 through 19
Needs to Improve	5 through 10
Substantial Noncompliance	0 through 4

Source: Federal Financial Institutions Examination Council

SMALL INSTITUTIONS

A “small institution” is defined as an institution with total assets amounting to less than \$250 million, independent or affiliated with a holding company that has total bank and thrift assets of less than \$1 billion, for two preceding years. Small institutions are evaluated under a streamlined test that focuses primarily on lending activities. When evaluating a small institution, an agency considers its loan-to-deposit ratio; the percentage of loans in its assessment areas; its record of lending to borrowers of different income levels, as well as businesses and farms of different sizes; the geographic distribution of its loans; and its record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in assessment area(s).

LIMITED PURPOSE AND WHOLESALE INSTITUTIONS

ILCs do not typically take the form of a limited purpose or wholesale institution. A limited purpose institution offers only a narrow product line (such as credit card or motor vehicle loans) to a regional or broader market and must request and receive designation as a limited purpose institution from its regulatory agency. A wholesale institution is not in the business of extending home mortgage, small business, small farm, or consumer loans to retail customers, and similarly must obtain a designation as a wholesale institution. The community development test is the evaluation method used for both limited purpose and wholesale institutions

STRATEGIC PLAN

The federal agencies developed the strategic plan option to provide institutions with more flexibility and certainty regarding what aspects of their performance will be evaluated and what quantitative and qualitative measures will be applied. To exercise this option, an institution must informally seek suggestions from the public while developing its plan, solicit formal public comment on its plan, and submit the plan to its regulatory agency (along with any written comments received from the public and an explanation of any changes made to the plan in response to those public comments). To be approved by an agency, a CRA

To be approved by an agency, a CRA strategic plan must have measurable goals and address how the institution plans to meet the credit needs of its assessment area, in particular, low- to moderate-income geographies and individuals, through lending, investments, and services, as deemed appropriate.

strategic plan must have measurable goals and address how the institution plans to meet the credit needs of its assessment area, in particular, low- to moderate-income geographies and individuals, through lending, investments, and services, as deemed appropriate. Although strategic plans should generally emphasize lending goals, this rule allows institutions the flexibility to choose a different emphasis, as necessary, given their business strategy and the individual needs of their community.

Developing and obtaining approval of a strategic plan takes great effort, but once the plan is in place, the rating of the company is fairly straightforward. Furthermore, because the bank set its own criteria for earning a “satisfactory” or “outstanding” rating within the guidelines of the CRA code, it knows exactly what must be done to receive those ratings. The plan usually takes three to five years to develop.

PERFORMANCE CONTEXT

In addition to their quantitative assessment of the amount of a financial institution’s community development activities, examiners make qualitative assessments of an institution’s leadership in community development matters and the complexity, responsiveness, and impact of the community development activities of the institution. In reaching a conclusion about the impact of an institution’s community development activities, examiners may, for example, determine that a loan to one small business in a low- or moderate-income geography that provides needed jobs and services in that area may have a greater impact and be more responsive to community credit needs than does a loan granted to another small business in the same geography that does not directly provide additional jobs or services to the community. These regulations provide that an institution’s performance under the stated tests and standards is evaluated within the context of available information about the institution, its community, its competitors, and its peers. Such information may include:

1. Demographic data on median income levels, distribution of household income, nature of housing stock, housing costs, and other relevant data pertaining to a bank's assessment area(s);
2. Any information about lending, investment, and service opportunities in the bank's assessment area(s) maintained by the bank or obtained from community organizations, state, local, and tribal governments, economic development agencies, or other sources;
3. The bank's product offerings and business strategy, as determined from data provided by the bank;
4. Institutional capacity and constraints, including the size and financial condition of the bank, the economic climate (national, regional, and local), safety and soundness limitations, and any other factors that significantly affect the bank's ability to provide lending, investments, or services in its assessment area(s);
5. The bank's past performance and the performance of similarly situated lenders;
6. The bank's public CRA file and any written comments about the bank's CRA performance submitted to the bank or the regulatory agency; and any other information deemed relevant by the agencies.¹²

Some agencies assert that performance context provides a means to evaluate the qualitative impact of an institution's activities in a community, striking the right balance between the quantity and quality of an institution's activity. Appropriate information helps to assess the responsiveness of an institution's activities to community credit needs. Performance context may also provide insight into whether an activity involving a lower dollar amount could meet community needs to a greater extent than an activity with a higher dollar amount, but with less innovation, complexity, or impact on the community.

Traditional banks are often able to meet their CRA requirements simply by conducting business as usual, ensuring that the low- to moderate-income segments of their local market are being served.

Because of the emphasis on context, regulatory agencies have avoided establishing a specific amount or investment percentage for meeting CRA requirements. Traditional banks are often able to meet their CRA requirements simply by conducting business as usual, ensuring that the low- to moderate-income segments of their local market are being served. Since ILCs do not have

traditional bank offerings and as much as 99 percent of their customers are located outside of Utah, companies emphasize investments, service, and community development projects. Currently, the "rule of thumb" in this industry for the appropriate amount of funds to contribute to CRA projects is one percent of assets.

If an institution has adequately addressed the community development needs of its assessment area(s), examiners will consider its community development activities that benefit geographies or individuals located somewhere within a regional area that includes the institution's assessment area(s) or statewide, even if those activities do not benefit its assessment area(s). This is especially important to Utah since a majority of the states \$82 billion ILC industry assets is located in Salt Lake County and the area may not be able to hold \$820 million in CRA investment funds.



The CRA prerequisite does not require a bank to make loans or investments or to provide services that are inconsistent with "safe and sound" operations. The FDIC anticipates that banks can meet CRA standards with "safe and sound" loans, investments, and services on which the banks expect to make a profit. Thus, banks are permitted and encouraged to develop and apply flexible underwriting standards for loans that benefit low- or moderate-income geographies or individuals, if consistent with "safe and sound" operations.

CRA ACTIVITIES OF UTAH ILCs

Utah's ILCs support a variety of programs and activities to fulfill CRA requirements with low-income housing as a major focus. Many ILCs contribute to the Utah Community Reinvestment Corporation, established specifically to use funds from local banks to meet low-income housing needs and support other CRA-approved activities. Currently, \$30 million of the \$40 million fund is committed by ILCs. Many companies also participate in consumer credit education, programs for low-income families such as day-care, small

business lending, and various charitable organizations. The activities that are acceptable for CRA investment are varied (not an exhaustive list):

- Utah housing bonds;
- Low income housing projects;
- Grants to non-profit corporations (if they support low-income initiatives);
- Women and minority owned businesses;
- Small businesses;
- Child care programs (if geared to low-income people);
- “Credit” education and counseling;
- Refinancing (for low-income people who are currently being financed at extremely high rates); and
- Venture capital (through SBICs such as Wasatch Venture).

Several presidents of Utah ILCs expressed frustration over the requirement that the reinvestment be local because of competition from a number of other companies trying to do the same thing, making it difficult to harvest investment opportunities. Many desire less stringent regulations as to where and what investments can be made.

ROLE OF CRA FUNDS IN FINANCING SMALL BUSINESSES

The FDIC presumes that any loan to or investment in a SBDC, SBIC, or New Markets Venture Capital Company promotes economic development.

To be considered as “community development” under CRA code, a loan, investment or service, whether made directly or through an intermediary, must meet both a size test and a purpose test¹³. An activity meets the size requirement if it finances entities that either meet the size eligibility standards of the Small Business Administration’s Development Company (SBDC) or Small Business Investment Company (SBIC) programs,

or have gross annual revenues of \$1 million or less. To meet the purpose test, the business investment activity must promote economic development. An activity is considered to promote economic development if it supports permanent job creation, retention, and/or improvement for persons who are currently in low- to moderate-income brackets, or geographies or in other areas targeted for redevelopment by Federal, state, local, or tribal governments. The FDIC presumes that any loan to or investment in a SBDC, SBIC, or New Markets Venture Capital Company promotes economic development.

Small Business Investment Companies, privately owned and managed investment companies licensed and regulated by the SBA, invest exclusively in qualified small businesses. These companies can borrow up to four times the amount of private capital through a federally guaranteed funding system, although most SBICs don’t use the full amount of leverage possible. Small Business Investment Companies are allowed to invest up to 20 percent of their total fund in one company, including subsequent rounds of financing. The SBA will not license an SBIC with a board of directors or ownership controlled directly or indirectly in any magnitude by public officials or government entities.¹⁴ According to the SBA, there are approximately six SBICs in the State of Utah,

including Wasatch Venture Fund, Utah Ventures, and vSpring, which expects to receive its SBIC license by October. Most Utah-based SBICs have not used federal leverage.

In 2000, 51 businesses in Utah received \$33 million in financing from SBICs, up from 40 businesses and \$18 million in 1999.¹⁵ Comparatively, Colorado SBIC financing last year was \$215 million for 118 companies. On a national level, 4,639 companies received \$5.5 billion in 2000. Thirty-six percent of those companies were high-tech based.¹⁶

Several Utah ILCs including American Express Centurion Bank, GE Capital Financial, and Morgan Stanley Dean Witter currently invest some money in SBICs. To be attractive to ILCs, the SBIC must have a proven track record or have an experienced management team.

The next section discusses the venture capital environment in Utah, as it is relevant to the use of CRA funds for business investment.

ILC VENTURE CAPITAL INVESTMENT:

At the end of 2000, Utah's venture capital funding grew to \$593.9 million, a marked increase from \$260.6 million in 1999.¹⁷ (See Appendix B for growth chart of venture capital in Utah.) However, despite this recent surge in venture capital, Utah recently ranked 19th in venture capital, as compared to Gross State Product. In contrast, other states with high-tech centers fared better in this category. In specific, the State of Colorado, largely comparable in terms of technology and economic development, ranked 4th in venture capital funding.¹⁸



Utah fares well in meeting the needs of the State's seed and early-stage financing, with eight strong Utah-based venture capital firms primarily dedicated to early investment:

<i>Firm</i>	<i>Fund Size</i>	<i>Average Size of Investment</i>
1. Canopy Group	N/A	\$50,000-\$1 million
2. Cornerstone Capital Group	\$75 million	\$3-\$7 million
3. Granite Capital Partners	\$30 million	\$2-\$10 million
4. New Media Venture Partners	\$48 million	\$1-\$2 million
5. Peterson Ventures	\$100 million	\$500,000-\$10 million
6. Utah Ventures	\$77 million	\$500,000-\$3 million
7. vSpring	\$100 million (target)	\$500,000-\$4 million
8. Wasatch Venture Fund	\$60 million	\$250,000-\$1 million

(See Appendix C for a contact list of VC firms that are SBIC licensed.)

These firms have relatively small amounts of capital under management, when compared to their Silicon Valley counterparts, and thus tend to provide seed and early-stage funding, dedicating only a small portion of their resources to larger, expansion round investments.

According to equity research firm Venture Economics, in the first half of 2000, the average investment in a Utah start-up was valued at \$3.1 million, compared to \$6 million per company in New York.¹⁹ While many Utah-based start-ups initiated operations with seed funding from Utah venture firms, venture capital firms located outside of Utah contribute a majority of this average investment.

From 1996 to 2000, only two Utah-based venture-backed companies went public, for a total value of \$116.7 million. This general lack of Utah-based second- and third-stage financing has resulted in entrepreneurs hitting the "Wasatch Wall," or the difficulty encountered by founders in taking their company to the next level. Three critical elements are required to take a start-up company over the "Wasatch Wall":

1. Attracting seasoned senior management;
2. Raising second- and third-round financing; and
3. Establishing key relationships with national law firms and investment banks.²⁰

Thus, entrepreneurs often end up pursuing a merger or acquisition strategy, resulting in few Utah-based IPOs and oftentimes the exportation of human and financial capital to the location of the parent company.

One reason companies often experience difficulty obtaining capital in later stages is that most local funds tend to be smaller, resulting in a shortage of capital dedicated to this area of funding. Furthermore, it is atypical for VC firms to invest in companies located outside their respective locations, especially since they tend to have promising investment opportunities in their backyard. Industrial Loan Corporations can play a major role in alleviating the second- and third-round financing discrepancy that is often critical to a company's ability to make an initial public offering.

Industrial Loan Corporations represent an \$82 billion industry in Utah, projected to grow to \$100 billion by year-end.²¹ The CRA, with which ILCs are required to comply, mandates that ILCs invest in the communities in which they are headquartered, as deemed appropriate by the FDIC and State Commission of Financial Institutions. In this realm, most banks have instigated a rule of thumb of committing approximately one percent of their assets, amounting to a grand total about \$820 million to \$1 billion in available CRA funds. However, since the FDIC largely feels that there is more funding available than investment opportunity, it provides satisfactory CRA ratings to those banks that show "good faith" effort in cultivating community needs and fulfilling investment opportunities. These ratings have indirect implications, impacting an ILC's credibility and may come into play when an ILC is expands or is acquired.

Currently, a majority of CRA investment is dedicated to financing low-income housing. However, a number of ILCs have made small investments in SBIC sponsored venture capital firms, most notably Wasatch Venture Funds and Utah Ventures. The main requirement for banks' investments in this area is that they meet a "safe and sound" stipulation, often marked by an entity's good track record and a sound management team.

The issue of venture capital investment from ILC's CRA monies is an issue that needs immediate attention before regulators get too heavily involved in the activities of ILCs.

This presents an opportunity to allocate a reasonable portion, 20 to 30 percent of the substantial CRA funding pool of approximately \$1 billion to entities dedicated to later stage financing and thus, Utah's future economic well being. Several steps must be taken in order to fully realize this opportunity:

1. While Governor Leavitt cannot legally play a direct role in the establishment of SBICs dedicated to second- and third-round funding, he can assume a visionary role for ILC investment in venture funding, encouraging the formation of these entities, ILC adoption, and state and federal government support. These investments should be considered investments in Utah's future economic growth,

benefiting all, as opposed to a diversion from the needs of Utah's economically challenged.

2. To effectively fulfill the "safe and sound" investment requirement, new entities formed such as SBICs need to be presided over by seasoned leadership with well known, proven track records in second- and third-round financing. This may require encouraging outsiders with ties to Utah to initiate and lead these entities, augmented by local management that have deep rooted knowledge of and experience with Utah's technology landscape. This could also involve a Utah firm partnering with an outside firm to establish a new fund. It is important also to emphasize that later stage financing in companies with a proven and established track records is often less risky than seed investment, providing a more compelling argument for investment in this area.

These actions will help provide alternative outlets for vast CRA investment resources, helping to channel venture funding to safer areas of venture investing where it is needed most, later stage financing. Industrial Loan Corporations' commitment to this vision will stimulate economic vitality and job growth in Utah through enabling promising companies to break the barrier of the "Wasatch Wall," providing an avenue for more IPO strategies and fewer merger and acquisition strategies where companies often go undervalued.

ILCS IN UTAH

Contrary to popular perception, the ILC industry is a “clean” and stable industry, importing large amounts of capital to Utah. The ILC industry is a key contributor to the state providing jobs, infusing capital (see Appendix D for consolidated income statement) into the region through taxes, state fees, community reinvestment monies, and commercial real estate rents.

EMPLOYMENT BENEFITS

ILCs do not just provide capital nor do they just take advantage of Utah’s business environment; they add value by providing good jobs that people can make a decent living with and including benefit packages with tuition reimbursement (helping people go to college who otherwise would not be able to afford it). Industrial Loan Corporations also provide excellent career paths internally for talented individuals. It is estimated that ILCs in Utah employ close to 10,000 people, the majority of which are functioning in higher income, skilled positions. American Express is easily the state’s largest employer for ILCs—employing approximately 2,000 people in Salt Lake County.

REPUTATION/RECOGNITION BENEFITS

There is a certain amount of prestige that is being attributed to Utah in the financial sector because of the critical mass of ILCs within the State. This will undoubtedly have spillover effects in attracting other industries, particularly with the larger financial services sector, and effectively change the brand of Utah in the minds of Americans and the world at large. Utah has been alluded to as the “Delaware of the West”—in reference to the friendly banking and business policies that have been historically present in Delaware.

Booming growth in the financial services sector in Utah is forcing the rest of the U.S. to take notice. ILC presidents interviewed mentioned that when forming an ILC there is initially some resistance from non-Utah natives to re-locate in Utah when their parent company is forming an ILC, given time to adjust, employees are very happy with the environment and decide to stay.

COMMUNITY BENEFITS

CRA investments from ILCs have a large impact in the community at large. Utah’s ILCs contribute monies to various community programs to help low- to moderate-income individuals and families. ILCs in Utah have large, strong parent companies with sophisticated management and large reputations to maintain; thus, they are not going to make any mistakes in the communities in which they reside.

ILCs in Utah have large, strong parent companies with sophisticated management and large reputations to maintain.

ECONOMIC BENEFITS

Not only does Utah's presence in ILCs attract attention from the financial services sector, but several parent companies have also chosen to expand beyond their ILCs, after experiencing the state's business environment. For example, GE, the parent company of GE Capital Financial, has made acquisitions in Utah in areas that are unrelated to its ILC, in large part due to the company's increased familiarity with the Utah business environment.



REGULATORY ENVIRONMENT

Utah's reputation for a positive regulatory environment has been a major factor in its ability to attract a critical mass of ILCs, as the leading state in the ILC industry. The Utah Department of Financial Institutions (UDFI) regulates Utah's ILCs at the state level. The relevant federal regulator is the FDIC.

ILCs are allowed to export the state's laws in which they are chartered, thus allowing Utah ILCs to do business in multiple states while adhering only to Utah laws, which are more lax than those in other states.

For those companies choosing to export consumer credit products to national markets, the Utah Consumer Credit Code is as flexible and direct as any in the nation. Furthermore, it enables ILCs to do business across state lines, without being subject to the regulatory environment of other states, resulting in significant increases in efficiency and a decreasing marginal cost of doing business. ILCs are allowed to export the state's laws in which they are chartered, thus allowing Utah's ILCs to do business in multiple states while adhering only to Utah laws, which are more lax than those in other states. ILCs

chartered in Utah can export their interest rates (which Utah does not limit) and credit terms without obtaining a license in each state they do business in—minimizing transaction costs and maximizing returns. ILCs are taking full advantage of this allowance, with an estimated 99 percent of business conducted outside the State.

COMPANY PROFILES

Utah has 31-chartered ILCs; although, five of these ILCs are currently inactive. These inactive ILCs present potential additions to the asset level of the Utah ILCs in the event that they become active. The following companies are not operating at this time:

- Coil Holding, Inc.
- Franklin Templeton Credit Corporation
- Life Wise Financial Services, Inc.
- Pain Webber Financial, Corp.
- USAA Financial Services Association

The following profiles are of the 26 active ILCs in Utah:

Advanta Bank Corp.

Member FDIC

Advanta Bank Corporation
11850 So. Election Drive
Draper, UT 84020
Tel: (801) 523-0858
www.advantabankcorp.com

Holding Company: Advanta Corporation

President: Jeffrey D. Beck

Quick Facts

Date Chartered	3/06/90
Assets (000) (as of 3/31/01)	946,563
CRA Rating (for 2001)	Satisfactory
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Salt Lake City, Utah, Advanta Bank Corp (ABC) is a subsidiary of Advanta Corp., a financial services company. ABC had over \$900 million in assets as of March 31, 2001. ABC's main activities are small business credit cards. Advanta's stated mission is to offer deposit products at competitive rates.



American Express Centurion Bank

American Express Centurion Bank
 6985 Union Park Center, Suite 235
 Midvale, UT 84047
 Tel: (801) 565-5000
www.finance.americanexpress.com

Holding Company: American
 Express Company

President: David E. Poulsen

Quick Facts

Date Chartered	6/29/87
Assets (000) (as of 3/31/01)	17,008,894
CRA Rating (for 2000)	Outstanding
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Midvale, Utah, American Express Centurion Bank is a provider of banking and credit card lending services. With over \$17 billion in assets, American Express Centurion Bank is the second largest industrial loan corporation in Utah, second only to Merrill Lynch Bank USA. The company employs approximately 1,400 Utahns.



American Investment Financial
 7575 South 900 East
 Midvale, UT 84047
 Tel: (801) 352-2877
www.aifusa.com

Holding Company: Leucadia
 National Corporation

President: Kent Landvatter

Quick Facts

Date Chartered	10/09/87
Assets (000) (as of 3/31/01)	102,276
CRA Rating (for 1998)	Satisfactory
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Midvale, Utah, American Investment Financial, a subsidiary of Leucadia National Corporation, a multi-billion dollar financial services company, specializes in providing consumer lending in the form of small business loans, financing credit-challenged customers at Marine & RV dealerships, and savings and branch services.



Associates Capital Bank

Associates Capital Bank
111 East 300 South, 6th Floor
Salt Lake City, UT 84111
Tel: (801) 715-7456
www.associatescapitalbank.com

Holding Company: Associates First
Capital Corp., Citigroup

President: Brian Withham

Quick Facts

Date Chartered	4/27/93
Assets (000) (as of 3/31/01)	169,809
CRA Rating (for 2000)	Outstanding
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Salt Lake City, Utah, Associates Capital Bank is a subsidiary of Citigroup and The Associates. Associates Capital provides consumer finance, commercial leasing and financing, credit cards, insurance, and related services to more than 24 million customers worldwide. On November 30th, 2000, Citigroup officially acquired The Associates.



BMW Financial Services :

BMW Bank of North America
2735 East Parley Way, Suite 301
Salt Lake City, UT 84109
Tel: (801) 994-7885
www.banking.bmwusa.com

Holding Company: BMW of North America

President: David Paul

Quick Facts

Date Chartered	9/30/99
Assets (000) (as of 3/31/01)	954,255
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Salt Lake City, Utah, BMW Bank of North America is a subsidiary of BMW Financial Services (BMW FS). BMW chartered its ILC to deliver a broad range of financial services with the same value to customers that the BMW brand represents. BMW Bank of North America offers automobile financing, personal banking products (checking, saving, CDs and money market accounts), and the BMW Bank credit card.

Celtic Bank

Celtic Bank
340 East 400 South
Salt Lake City, UT 84111
Tel: (801) 363-6500
www.celticbanking.com

Holding Company: Celtic
Investments, Salt Lake Mortgage

Vice-President: Reese Howell

Quick Facts

Date Chartered	3/01/01
Assets (000) (as of 3/31/01)	3,884
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Salt Lake City, Utah, Celtic Bank is a subsidiary of Celtic Investments, which merged with Salt Lake Mortgage in 1997. Celtic Bank's activities include mortgages and small commercial loans.



CIT Online Bank

CIT Online Bank
2855 E. Cottonwood Pkwy
Suite 110
Salt Lake City, UT 84121
Tel: (801) 947-7563
www.citgroup.com (parent)

Holding Company: CIT Group, Inc.

Contact: Richard P. Lake

Quick Facts

Date Chartered	10/10/00
Assets (000) (as of 3/31/01)	17,373
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Salt Lake City, Utah, CIT Online Bank provides financial products and services to consumers nationwide to purchase merchandise or services through vendors. CIT Online Bank is a wholly owned subsidiary of CIT Group, Inc.

CitiFinancial Services, Inc.

CitiFinancial Services, Inc.
The Family Center of Midvalley
5672 So. Redwood Rd, Box 57880
Murray, UT 84157
Tel: (801) 728-9186
www.citigroup.com (parent)

Holding Company: Citigroup

Contact: Bill Clements, Jr., District
Manager

Quick Facts

Date Chartered	1976
Assets (000) (as of 6/30/00)	35,798
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Murray, Utah, CitiFinancial Services, a subsidiary of Citigroup, specializes in a myriad of financial services ranging from personal loans to refinancing on large commercial loans. The company also offers credit protection on loans.



Conseco Bank, Inc.
 2825 East Cottonwood Pkwy
 Suite 230
 Salt Lake City, UT 84121
 Tel: (801) 944-3374
www.consecobank.com

Holding Company: Conseco, Inc.

CEO: Brent Peterson

Quick Facts

Date Chartered	2/18/97
Assets (000) (as of 3/31/01)	2,350,834
CRA Rating (for 2000)	Satisfactory
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Conseco Bank, Inc., headquartered in Salt Lake City, Utah, is a wholly owned subsidiary of Conseco Finance Corp. Conseco Bank, Inc. began operation on December 1, 1997 as Green Tree Capital Bank, Inc., and took on its current name on June 30, 1998 when Conseco, Inc. - a large insurance company in Carmel, Indiana - acquired Green Tree Financial Corporation and all of its subsidiaries.

Conseco Bank, Inc. does not have any branch offices or deposit-taking ATMs. All deposits are acquired either through brokers, through the Web site, or over the phone. The business focus of Conseco Bank, Inc. is national in scope. They originate consumer, small business, commercial credit card loans, and residential mortgage loans throughout the United States. The largest category in their loan portfolio is private label credit card products, with account partnerships throughout the United States. Conseco is authorized to originate many kinds of consumer and commercial loans and to accept federally insured deposits.



Escrow Bank USA
6955 Union Park Center, Suite 300
Midvale, UT 84047
Tel: (801) 352-0083
www.escrowbankusa.com

Holding Company: GMAC
Mortgage Group, Inc.

President: Steve Nielsen

Quick Facts	
Date Chartered	05/27/99
Assets (000) (as of 3/31/01)	41,219
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Date Chartered	05/27/99
Assets (000) (as of 3/31/01)	41,219
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Escrow Bank USASM, headquartered in Midvale, Utah, provides escrow accounts and document custodial services to mortgage servicers. Escrow, a subsidiary of GMAC Mortgage Group, Inc. also provides automated deposit processing and document custodial services.

First Electronic Bank

First Electronic Bank
11781 S Lone Peak Pkwy
Draper, UT 84020
Tel: (801) 572-4004

Holding Company: First Electronic Corporation

President: Jim McLaughlin

Quick Facts

Date Chartered	10/18/00
Assets (000) (as of 3/31/01)	5,457
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Headquartered in Draper, Utah, First Electronic bank, a subsidiary of First Electronic Corporation, specializes in financing electronic equipment. An active ILC for less than a year, First Electronic Bank had just over \$5 million in assets as of March 2001.



First USA Financial Services, Inc.
3995 South 700 East
Salt Lake City, UT 84107
Tel: (801) 281-5800
www.bankone.com (parent)

Holding Company: Bank One, Corp

President: James W. Baumgartner

Quick Facts

Date Chartered	10/24/94
Assets (000) (as of 3/31/01)	213,972
CRA Rating (for 1999)	Needs to Improve
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Headquartered in Salt Lake City, Utah, First USA Financial Services, Inc., a subsidiary of Bank One, Corp., provides business, travel, and entertainment credit cards to its customers. Assets for First USA Financial Services totaled over 200 million dollars in March 2001.

GE Capital Financial Inc.

GE Capital Financial
4256 South Riverboat Road
Salt Lake City, UT 84123
Tel: (801) 517-5000
www.ge.com/capital/cardservices/orpcard

Holding Company: GE Capital
Corp, GE Company

President: Jeffrey R. Dye

Quick Facts

Date Chartered	6/21/90
Assets (000) (as of 3/31/01)	1,768,525
CRA Rating (for 1999)	Outstanding
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Salt Lake City, Utah, GE Capital Financial Inc. is part of GE Card Services. GE Card Services is one of 28 specialized businesses that comprise GE Capital Services.

GE Capital Financial Services provides corporate travel, purchasing, one card, and fleet vehicle card payment systems for large companies and organizations. Their products and services are designed for companies with annual revenues greater than \$300 million, and for government or other large organizations.

MERRICK BANK

Merrick Bank Corporation
10713 So. Jordan Gateway
Suite 150
South Jordan, UT 84095
Tel: (801) 685-7700
www.merrickbank.com

Holding Company: Card Works, LP

President: Richard L. Urritia

Quick Facts

Date Chartered	10/15/96
Assets (000) (as of 3/31/01)	296,956
CRA Rating (for 2000)	Satisfactory
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in South Jordan, Utah, Merrick Bank was founded in 1996 and is a top 50 issuer of Visa[®] credit cards. They are also an authorized issuer of MasterCard[®] credit cards. Merrick Bank serves 450,000 cardholders. Merrick Bank specializes in credit programs that assist consumers looking to establish or rebuild their credit rating. Merrick Bank also offers Certificates of Deposit.

Merrick Bank's parent, CardWorks L.P., and affiliate, Cardholder Management Services, L.L.C., (CMS), are both based in New York.



Merrill Lynch Bank USA
15 West South Temple, Suite 300
Salt Lake City, UT 84101
Tel: (801) 526-8300
www.ml.com (parent)

Holding Company: Merrill Lynch
Group, Inc.

President: Preston L. Jackson

Quick Facts	
Date Chartered	12/15/87
Assets (000) (as of 3/31/01)	54,233,264
CRA Rating (for 2001)	Satisfactory
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Headquartered in Salt Lake City, Utah, Merrill Lynch Bank USA, a subsidiary of Merrill Lynch Group, Inc., is the largest industrial loan corporation in Utah, over double the size of its nearest competitor. The company specializes in loans secured by Merrill Lynch brokerage accounts and also in mortgages. Merrill Lynch Bank USA has the largest amount of assets of any Utah-chartered ILC.



Morgan Stanley Dean Witter Bank
855 East 9400 South
Sandy, UT 84094
Tel: (801) 566-4161
www.morganstanley.com (parent)

Holding Company: Morgan Stanley
Dean Witter, Discover & Co.

President: Robert D. Myrick

Quick Facts	
Date Chartered	5/21/90
Assets (000) (as of 3/31/01)	648,132
CRA Rating (for 2000)	Satisfactory
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Headquartered in Sandy, Utah, Morgan Stanley Dean Witter Bank, is a subsidiary of Morgan Stanley Dean Witter Company and Discover & Co. The company specializes in issuing commercial loans to its financial services customers, specifically for securities, asset management, and credit services.



Pitney Bowes Bank
4444 South 700 East, Suite 200
Salt Lake City, UT 84107
Tel: (801) 281-5522
www.pb.com (parent)

Holding Company: Pitney Bowes,
Inc.

President: Zock B. Goeckeritz

Quick Facts	
Date Chartered	11/25/96
Assets (000) (as of 3/31/01)	224,604
CRA Rating (for 2000)	Satisfactory
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Headquartered in Salt Lake City, Utah, Pitney Bowes Bank, a subsidiary of Pitney Bowes, Inc., specializes in small business credit cards.

Pitney Bowes Bank offers a PitneyWorks Business Rewards VISA card that is designed for business owners and their employees. Pitney Bowes Bank also extends its product line by also offering services that compliment its primary business offering. For example, the Pitney Bowes Reserve Account is designed for customers who prefer to pre-pay postage. With the Reserve Account, customers can deposit their postage money with the Pitney Bowes Bank and earn free postage on balances maintained in their accounts.



Providian Bank
5215 Wiley Post Way, Suite 200
Salt Lake City, UT 84116
Tel: (801) 519-0555
www.providian.com

Holding Company: Providian
Financial Corporation

President: Mark Zupon

Quick Facts	
Date Chartered	5/05/87
Assets (000) (as of 3/31/01)	2,319,153
CRA Rating (for 1998)	Satisfactory
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Headquartered in Salt Lake City, Utah, Providian Bank is a subsidiary of Providian Financial Corporation. Providian Bank's core business activities focus on providing credit card services. Providian employs approximately 1,100 people in the Salt Lake area. Customer service employees constitute 1/3 of their employee base in Utah.

Republic Bank

Republic Bank
801 North 500 West
West Bountiful, UT 84087
Tel: (801) 397-0613
www.republic-bank.com

Holding Company: Individual
stockholders

President: Boyd Lindquist

Quick Facts

Date Chartered	11/03/99
Assets (000) (as of 3/31/01)	88,276
CRA Rating (for 2001)	N/A
County of Operation	Davis
Source: Utah Depart. Of Financial Institutions	

Headquartered in West Bountiful, Utah, Republic Bank, an industrial loan corporation held by individual stockholders, specializes in medical equipment financing, CDs and money market accounts. The company is the successor to Republic Bank of Torrance, California.



Transportation Alliance Bank
 4185 Harrison Blvd, Suite 200
 Ogden, UT 84404
 Tel: (801) 334-4800
www.tabbank.com

Holding Company: Flying J, Inc.

President: Clint E. Williams

Quick Facts

Date Chartered	5/05/98
Assets (000) (as of 3/31/01)	43,704
CRA Rating (for 2001)	Satisfactory
County of Operation	Weber

Source: Utah Depart. Of Financial Institutions

Headquartered in Ogden, Utah, Transportation Alliance Bank is a subsidiary of Flying J and specializes in accounts receivable financing, factoring, and equipment loans for the trucking industry. Flying J debit cards are additionally available from Transportation Alliance Bank.

Transportation Alliance Bank is a provider of accounts receivable financing and factoring for the trucking industry and financial services such as checking accounts with the Frequent Fueler MoneyCard MasterCard debit card and online banking, truck loans and equipment loans, and more. As a subsidiary of Flying J Inc., their financial services are designed to meet the unique needs of owner operators and the trucking industry in general. Transportation Alliance Bank is one of only two ILCs located outside of Salt Lake County.

Universal Financial Corp.

Universal Financial Corp.
2855 E Cottonwood Pkwy
Suite 120
Salt Lake City, UT 84121
Tel: (801) 453-1380

Holding Company: Citigroup

President: Steve Taylor

Quick Facts

Date Chartered	3/03/92
Assets (000) (as of 3/31/01)	559,720
CRA Rating (for 1999)	Satisfactory
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Universal Financial is headquartered in Salt Lake City, Utah, and is a subsidiary of Citigroup. Their main activities include providing credit cards for the travel and entertainment industries.

Valley Loan Corporation

Valley Loan Corporation
2105 West 4700 South
Murray, UT 84107
Tel: (801) 968-9093

Holding Company: Independent

President: Robert I. Bowes

Quick Facts

Date Chartered	1957
Assets (000) (as of 3/31/01)	600
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Murray, Utah, Valley Loan Corporation, is a small industrial loan corporation with assets just over \$600,000. Chartered in 1957, Valley Loan Corporation is an independent ILC and has no parent company backing.



Volvo Commercial Credit Corp. of
Utah
4179 Riverboat Road
Salt Lake City, UT 84123
Tel: (801) 266-8524
www.volvo.com (parent)

Holding Company: Volvo
Commercial Finance LLC, The
Americas

President: Wallace M. Jensen

Quick Facts	
Date Chartered	3/13/00
Assets (000) (as of 3/31/01)	11,101
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Headquartered in Salt Lake City, Utah, Volvo Commercial Credit Corporation of Utah, a subsidiary of Volvo Commercial Finance LLC, provides credit card services and financing for heavy truck purchases.



Web Bank Corp.
6440 Wasatch Blvd. Suite 300
Salt Lake City, UT 84121
Tel: (801) 993-5050
www.webbank.com

Holding Company: WebFinancial Corporation

President: Kenneth H. Peterson

Quick Facts	
Date Chartered	4/04/94
Assets (000) (as of 3/31/01)	16,043
CRA Rating (for 2000)	Satisfactory
County of Operation	Salt Lake
Source: Utah Depart. Of Financial Institutions	

Headquartered in Salt Lake City, Utah, WebBank is a wholly owned subsidiary of WebFinancial Corporation. The company provides a spectrum of customized loan products and financial services, ranging from private label credit cards to small business loans. WebBank will also offer mortgage warehousing services in the near future.



Wright Express Financial Services
5353 South 960 East, Suite 200
Murray, UT 84117
Tel: (801) 270-2660
www.wexcorporatecard.com

Holding Company: Wright Express
LLC

President: Steven A. Hoskins

Quick Facts

Date Chartered	10/02/97
Assets (000) (as of 3/31/01)	243,963
CRA Rating (for 2001)	Satisfactory
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Headquartered in Murray, Utah, Wright Express offers a variety of corporate charge card programs for managing fleet, travel and entertainment, and purchasing expenditures—for example the Wright Express Corporate Card, a MasterCard issued by Wright Express Financial Services Corporation. The company also offers the Wright Express Universal Fleet Card, for all corporate transportation and travel financing needs.

Your:)Bank.com

Your:)Bank .com
5420 West 2100 South
Salt Lake City, UT 84121
Tel: (801) 412-6524

Holding Company: Gateway
Companies, Inc.

President: John L. Richards

Quick Facts

Date Chartered	12/11/00
Assets (000) (as of 3/31/01)	31,811
CRA Rating (for 2001)	N/A
County of Operation	Salt Lake

Source: Utah Depart. Of Financial Institutions

Your:)Bank.com, headquartered in Salt Lake City, Utah, and a subsidiary of Gateway Companies, Inc., specializes in financing computer equipment.

CONCLUSIONS AND RECOMMENDATIONS

There is vast potential for the ILC market and what it can bring to Utah. In specific, the potential to channel CRA investments into second- and third-round venture capital funding presents a real opportunity for Utah to further develop and strengthen its high-tech base, and thus its economy, having vast implications for economically challenged communities.

The ability to harness this opportunity is largely dependent on the level of involvement in which the governor wishes to engage. He alone can assume the role of visionary, fostering the corporate citizenship of ILCs in Utah. Industrial Loan Corporations also have great incentive to garner the governor's goodwill and support, since they necessitate favorable regulations and legislation for their existence.

In this realm, one ILC president in Utah suggested that the governor reach out to ILCs that currently are not investing CRA funds in venture capital, asking them for their support in this endeavor and in return, championing their activities and contributions and giving them recognition for their actions.

The scope of the governor's influence will most likely encompass soliciting the help of the ILCs, the support of regulatory bodies, fostering goodwill, and recognizing ILCs for their upstanding corporate citizenship, since federal legislation is not in his direct control nor is the decision of companies to invest CRA funding in this manner. From these conclusions, the following recommendations are offered:

Recommendation #1: Influence ILCs to invest in Utah's future economic growth and health, benefiting everyone, by apportioning an appropriate amount of their CRA investment to later stage funding of venture capital in Utah. Governor Leavitt can play a key role in this process by providing this vision and garnering support not only among ILCs but also local, state, and federal government, as well as venture capital firms, banking associations such as the Utah Association of Financial Services, banking regulators, and Utah's citizens. It is important to emphasize that this initiative is not a diversion from the needs of Utah's economically challenged, but rather, an investment in Utah's future economic growth, benefiting all participants by stimulating economic vitality and job growth.

Recommendation #2: Encourage the formation of new SBICs to be set up in Utah that focus on second- and third-round venture funding. In order to effectively fulfill the "safe and sound" investment test imposed by the Department of Financial Institutions and the FDIC, this requires identifying a seasoned management team that has a track record of success in later stage financing. Investing through an SBIC is the simplest method for ILCs to meet CRA requirements for investing in small businesses. Since currently, Utah's SBICs are set up to focus mainly on seed funding, new SBICs licensed to fund second- and third-rounds should be established.

- Currently, a surplus of CRA monies are not being utilized in Utah because of the FDIC's perception that ILC investment efforts are more than adequate to meet the needs of the State, which is largely true for the traditional avenues through which CRA funds are channeled. However, the venture capital option is an underserved channel for CRA funds that seeks to proactively serve Utah's future needs.
- Generally, the proposed SBIC would not be a competitive threat for the majority of existing VC firms in Utah because they largely do not focus on second- and third-round funding. However, this could pose some competition in the sense that CRA funds previously directed towards SBICs focused on seed funding could potentially be redirected to new SBICs. This will be minimal since many ILCs are only contributing small CRA investments towards venture capital, if at all, because they pose risk factors that a conservative industry, such as the ILC industry, is generally uncomfortable with.
- Investing in companies that have solid track records and thus, have made it past first-round financing, and are oftentimes less risky than investing in seed and early expansion stages. Therefore, an SBIC doing second- and third-round funding should be more attractive to ILCs wanting to be involved in venture capital, since the companies invested in at this level tend to be larger, more established, and less risky than seed capital ventures they currently invest in.

Recommendation #3: Establish and champion a modest and attainable objective of securing ILCs' CRA funding, a suggested 20 percent, increasing the emphasis and endorsement of economic development in the form of venture capital through investment in SBICs.

- With current assets totaling \$82 billion, available CRA funds from local ILCs are approximately \$820 million (one percent of assets). Thus, 20 percent of CRA funds would be approximately \$164 million. This will likely grow to \$200 million by year-end when ILCs assets are expected to reach \$100 billion. This an adequate amount of capital to initiate second- and third-round funding of Utah's start-ups, while retaining a more than substantial amount of funds to address other community needs with CRA investments.
- This portion of CRA funds would be directed towards venture capital funds focused on second- and third-round funding—the missing link in Utah's venture capital environment.
- Currently, seed funding in Utah is considered by most to be adequate, while second- and third-round funds are considerably lacking. Second- and third-round funding is not as risky as seed funding and can better achieve the "safe and sound" requirements of the Department of Financial Institutions and the FDIC.

Recommendation #4: Develop and conduct a public relations campaign that articulates the importance of ILCs to Utah's economic development and the important role they can

play in funding some of the State's most promising companies and innovations, building and strengthening Utah's economic future—ultimately benefiting all Utahns. The understanding of appropriate apportioning of and channels for ILCs' CRA funding requirements is not consistent across the board. Research conducted indicates that, more often than not, ILCs, government agencies, local venture capitalists, and community entities have contrasting interpretations and viewpoints in this area. The alignment of these groups is crucial to maximizing the potential of the ILC industry in this endeavor.

Recommendation #5: Create avenues for recognition of local ILCs and the great impact they can have on Utah's economy and the community at large. Delineate the positive benefits Utahns derive from having a critical mass of ILCs within the state. This may include an influx of higher paying, skilled jobs, funding for community enhancement, and prestige for Utah as a financial center.

Recommendation #6: Convey the benefits of and potential implications for the ILC industry in Utah to legislative decision-makers, engendering continued support. Emphasize the importance of having a critical mass of ILCs remain in the State, as well as the fact that their tenure here can be tenuous, dependent upon the future regulatory environment.

APPENDIX A:

CRA INVESTMENT CRITERIA

LENDING TEST

Scope of Test. The lending test evaluates the institution's record of helping to meet the credit needs of its assessment area(s) by considering an institution's home mortgage, small business, small farm, and community development lending. The institution's lending performance is evaluated pursuant to the following criteria:

- 1) The volume of lending activity
- 2) The proportion of lending within the assessment area(s)
- 3) The dispersion of loans in the assessment area(s)
- 4) The distribution of loans among borrowers of different income levels and businesses (including farms) of different sizes
- 5) The distribution of small business and small farm loans by loan amount at origination
- 6) The volume of community development lending
- 7) The use of innovative or flexible lending practices.

Performance under the lending test is weighted more heavily than the investment and service tests when arriving at an overall rating.

COMMUNITY DEVELOPMENT LENDING: PERFORMANCE CRITERIA

The institution's community development lending activities are evaluated pursuant to the following criteria:

- 1) The extent to which community development lending opportunities have been made available to the institution
- 2) The responsiveness of the institution's community development lending
- 3) The extent of leadership the institution has demonstrated in community development lending.

INNOVATIVE AND FLEXIBLE LENDING PRACTICES: PERFORMANCE CRITERIA

The institution's innovative and flexible lending practices are evaluated pursuant to the following criteria:

- 1) The degree to which the loans serve low- and moderate-income creditworthy borrowers in new ways or serve groups of creditworthy borrowers not previously served by the institution
- 2) The success of each product, including the number and dollar volume of loans originated during the review period.

INVESTMENT TEST

Scope of Test. The investment test evaluates the institution's record of helping to meet the credit needs of its assessment area(s) through its use of qualified investments that

benefit the assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s). Activities considered under the lending or service tests may not be considered under the investment test.

The institution's investment performance is evaluated pursuant to the following criteria:

- 1) The dollar amount of qualified investments
- 2) The innovativeness or complexity of qualified investments
- 3) The responsiveness of qualified investments to credit and community development needs
- 4) The degree to which the qualified investments are not routinely provided by private investors.

SERVICE TEST

Scope of Test. The service test evaluates the institution's record of helping to meet the credit needs of its assessment area(s) by analyzing both the availability and effectiveness of the institution's systems for delivering retail banking services and the extent and innovativeness of its community development services. The institution's retail banking services are evaluated pursuant to the following criteria:

- 1) The distribution of the institution's branches among geographies of different income levels
- 2) The record of opening and closing branches, particularly branches located in low- and moderate-income geographies or that primarily serve low- or moderate-income individuals
- 3) The availability and effectiveness of alternate systems for delivering retail banking services
- 4) The range of services provided in low-, moderate-, middle-, and upper-income geographies.

In addition, the institution's community development services are evaluated pursuant to the following criteria:

- 1) The extent of community development services offered and used
- 2) The innovativeness of community development services, including whether they serve low- to moderate-income customers in new ways or serve groups of customers not previously served
- 3) The degree to which they serve low- and moderate-income areas or individuals
- 4) Their responsiveness to available opportunities for community development services.

(Source: Federal Deposit Insurance Corporation. Community Reinvestment Act Performance Evaluation: Public disclosure.)

SMALL BANK PERFORMANCE STANDARDS

The FDIC evaluates the record of a small bank, or a bank that was a small bank during the prior calendar year, of helping to meet the credit needs of its assessment area(s) pursuant to the following criteria:

- 1) The bank's loan-to-deposit ratio, adjusted for seasonal variation and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets, community development loans, or qualified investments;
- 2) The percentage of loans and, as appropriate, other lending-related activities located in the bank's assessment area(s);
- 3) The bank's record of lending to and, as appropriate, engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes;
- 4) The geographic distribution of the bank's loans; and
- 5) The bank's record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment area(s).

QUALIFIED INVESTMENTS

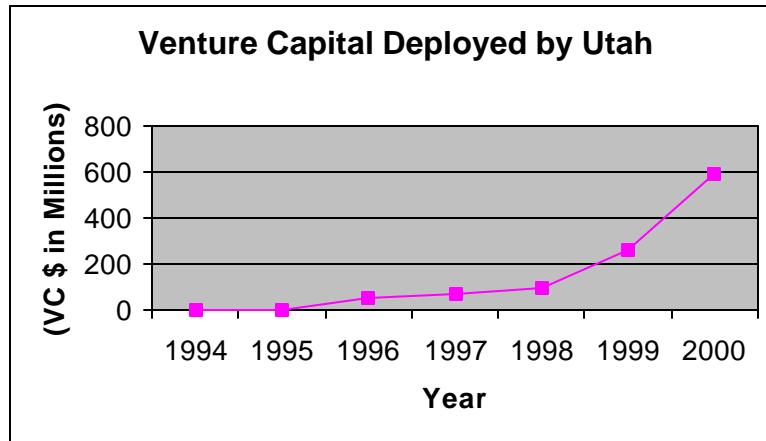
Examples of qualified investments include, but are not limited to, investments, grants, deposits, or shares in or to:

- Financial intermediaries (including, Community Development Financial Institutions (CDFIs), Community Development Corporations (CDCs), minority- and women-owned financial institutions, community loan funds, and low-income or community development credit unions) that primarily lend or facilitate lending in low- and moderate-income areas or to low- and moderate-income individuals in order to promote community development, such as a CDFI that promotes economic development on an Indian reservation;
- Organizations engaged in affordable housing rehabilitation and construction, including multifamily rental housing;
- Organizations, including Small Business Investment Companies (SBICs) and specialized SBICs, that promote economic development by financing small businesses;
- Facilities that promote community development in low- and moderate-income areas for low- to moderate-income individuals, such as youth programs, homeless centers, soup kitchens, health care facilities, battered women's centers, and alcohol and drug recovery centers;
- Projects eligible for low-income housing tax credits;
- State and municipal obligations, such as revenue bonds, that specifically support affordable housing or other community development;
- Not-for-profit organizations serving low- and moderate-income housing or other community development needs, such as counseling for credit, home-ownership, home maintenance, and other financial services education; and
- Organizations supporting activities essential to the capacity of low- and moderate-income individuals or geographies to utilize credit or to sustain economic development, such as, day care operations and job training programs that enable people to work.

APPENDIX B:

VENTURE CAPITAL GROWTH IN UTAH

The following chart illustrates the exponential growth in venture capital deployed by Utah in the last 7 years. Despite the growth, Utah still ranks low compared to other states in the nation.



APPENDIX C:

SBIC LICENSED UTAH VENTURE CAPITAL FIRMS

Below is a contact list of Utah's venture capital firms that currently have SBIC licenses, with the exception of vSpring, which should receive its SBIC license within the next six months. As SBIC licensees, these firms qualify to receive CRA funding from ILCs for investing in promising small businesses, and thus, their surrounding communities.

Venture Capital Firm	Contact	General Phone #
<i>Utah Firms:</i>		
<i>First Security Business Investment Corp.</i> (Salt Lake City, UT)	Greg Vidrine	(801) 246-1047
<i>Union Ventures, II & III</i> (Salt Lake City, UT) www.unionventures.com	James C. Dreyfous Alan Dishlip	(801) 583-5922
<i>Wasatch Venture Corporation, II & III</i> (Salt Lake City, UT) www.wasatchvc.com	Todd J. Stevens	(801) 524-8939
<i>Zions SBIC</i> (Salt Lake City, UT) www.associatescapitalbank.com	Todd J. Stevens	(801) 524-8939
<i>Pending:</i>		
<i>vSpring Capital</i> (Salt Lake City, UT) www.vspring.com	Paul Ahlstrom	(801) 942-8999

APPENDIX D:

CONSOLIDATED INCOME STATEMENT, UTAH ILCs

For the Six Month Period Ending June 30, 2000
Figures in Thousands, 23 ILCs reporting

	<u>Amount</u>
INTEREST INCOME	
Interest & Fee Income on Loans	\$ 1,330
Real Estate Loans	103,411
Installment Loans	120,178
Credit Cards	1,085,118
Commercial and Other Loans	466,204
Leasing	5,417
Interest on Balances Due	13,308
Securities	156,664
Other Interest Income	0
Interest on Federal Funds	<u>53,163</u>
TOTAL INTEREST INCOME	2,004,793
INTEREST EXPENSE	
Transaction Accounts	3,095
Money Market Accounts	102,940
Other Savings Accounts	842
Time CD's Greater than \$100,000	313,696
All Other Time CD's	39,312
Federal Funds Purchased	35,230
Demand Notes to U.S. Treasury	373,805
Interest on Mortgages	0
Notes and Debentures	<u>319</u>
TOTAL INTEREST EXPENSE	<u>869,239</u>
NET INTEREST INCOME	1,135,554
Provision for Loan Loss	400,608
NON INTEREST INCOME	
Service Charges	0
Other	<u>1,145,806</u>
TOTAL NONINTEREST INCOME	1,145,806
Gains (Losses) on Securities	1,358
NONINTEREST EXPENSE	
Salaries & Employee Benefits	140,798
Premises & Fixed Assets	21,314
Other	<u>877,211</u>
TOTAL NONINTEREST EXPENSE	<u>1,039,323</u>
INCOME (LOSS) BEFORE TAXES & EXTRAORDINARY ITEMS	842,787
Applicable Income Taxes	316,482
Extraordinary Items (Net of Taxes)	<u>0</u>
NET INCOME	<u><u>\$ 526,305</u></u>

FOOTNOTES

- ¹ Utah Industrial Loan Company (ILC) Backgrounder, Utah Department of Financial Institutions.
- ² “From Mormon to Mammon” *The Economist* 9 June 2001.
- ³ Utah Industrial Loan Company (ILC) Backgrounder, Utah Department of Financial Institutions.
- ⁴ “From Mormon to Mammon” *The Economist* 9 June 2001.
- ⁵ Katie Kuehner-Hebert “California Broadens Industrial Banks' Powers,” *The American Banker* 27 Nov 2000.
- ⁶ “From Mormon to Mammon” *The Economist* 9 June 2001.
- ⁷ “From Mormon to Mammon” *The Economist* 9 June 2001.
- ⁸ Federal Financial Institutions Examination Council. “Community Reinvestment Act.” At< <http://www.ffiec.gov/cra/history.htm>> 10 August 2001.
- ⁹ Dept. of the Treasury. 19 July 2001. “Proposed Rules.” At<http://www.ffiec.gov/cra/pdf/proposed_rules01.pdf> 6 August 2001
- ¹⁰ Ibid.
- ¹¹ Federal Financial Institutions Examination Council. 2001. “Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment.” At< <http://www.ffiec.gov/cra/qnadoc.htm>> 2 August 2001.
- ¹² Federal Financial Institutions Examination Council. 2001. “Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment.” At< <http://www.ffiec.gov/cra/qnadoc.htm>> 2 August 2001.
- ¹³ Ibid.
- ¹⁴ Small Business Association. 2001. “Small Business Investment Company Program.” At<www.sba.gov/INV/sbinfo.html> 6 August 2001.
- ¹⁵ Small Business Association. 2001. At<www.sba.gov/INV/stat/table7.doc> 6 August 2001.
- ¹⁶ Small Business Association. 2001. At<www.sba.gov/INV/stat/table13.doc> 6 August 2001.
- ¹⁷ Venture Economics. 2000. “National Venture Capital Profile for Utah.” At<http://www.ventureeconomics.com/stats/2000Q4/state_ut.html>. 9 August 2001.
- ¹⁸ Graham, W. Brett; Hawkins, Matthew J. & Reading, Jason B. 2001. *The Utah Venture Report*. Unpublished report, State of Utah.
- ¹⁹ Powell, Bonnie Azab. 2000. “Regional VCs: Utah.” At<http://www.redherring.com/index.asp?layout=story&channel=70000007&doc_id=720013872>. 10 August 2001.
- ²⁰ Graham, W. Brett; Hawkins, Matthew J. & Reading, Jason B. 2001. *The Utah Venture Report*. Unpublished report, State of Utah.
- ²¹ “From Mormon to Mammon.” *The Economist*. 9 June 2001.